

15-1795

TAX TYPE: SALES & USE TAX

TAX YEAR: 2012 – 2015

DATE SIGNED: 08/09/2017

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER,

Petitioner,

v.

AUDITING DIVISION OF THE UTAH STATE
TAX COMMISSION,

Respondent.

**FINDINGS OF FACT, CONCLUSIONS
OF LAW, AND FINAL DECISION**

Appeal No. 15-1795

Account No. #####

Tax Type: Sales & Use Tax

Tax Period: June 2012 through May 2015

Judge: Phan

Presiding:

Michael Cragun, Commissioner

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE FOR TAXPAYER-1, Attorney at Law
REPRESENTATIVE FOR TAXPAYER-2, Owner, TAXPAYER.
REPRESENTATIVE FOR TAXPAYER-3, Vice President of TAXPAYER.
REPRESENTATIVE FOR TAXPAYER-4, CFO for TAXPAYER.

For Respondent: REPRESENTATIVE FOR RESPONDENT-1, Assistant Attorney General
REPRESENTATIVE FOR RESPONDENT-2, Manager, Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on January 31, 2017, in accordance with Utah Code §59-1-1410 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioner (“Taxpayer”) is appealing the decision by Respondent (“Division”) to deny a sales and use tax refund request submitted by the Taxpayer for the period of June 1, 2012 through May 31, 2015. The Division had denied the request by Statutory Notice dated November 3, 2015.¹ The Taxpayer had timely appealed this denial and the matter proceeded to this Formal Hearing.

¹ Exhibit 3.

2. In the refund request, the Taxpayer had sought refund of the sales and use taxes paid on purchases of items of tangible personal property, which the Taxpayers asserted included “generators, pipes, motors, pumps, valves, hardware, components, & controls.” The Taxpayer stated in the refund request, “All items are above ground and can be removed or replaced without damage to the [tangible personal property] or to the structure in which they were placed in.”² The Division provided in the Statutory Notice that the reason for disallowing the refund was, “The amounts requested for refund were disallowed because the jobs were considered to be for real property improvements and the sales and use tax on purchases of tangible personal property was properly paid. See Administrative Rule R865-19S-58.”³ The amount of the refund requested was \$\$\$\$.

3. The Taxpayer is a general engineering contractor and constructs water and sewer pipeline systems or components of the systems primarily for Utah cities or Utah water conservancy districts. Much of the pipeline systems consist of underground pipelines, and the underground pipelines are not at issue in this appeal. However, the Taxpayer also constructs or upgrades components required in the systems like pumping stations, booster stations, well houses and diversion systems, and these components are comprised of mostly above ground equipment.

4. For the contracts that are at issue in the refund request, the Taxpayer contracts with the governmental entities to construct a functioning well house, pump station, or sewer lift for example. This may include construction of a building and installation of things like meters, gauges, pumps, valves, fittings, pipes and water purification systems. It is only this equipment; the meters, gauges, pumps, valves, fittings, pipes and water purification equipment installed above ground that is at issue in this refund request. These items of equipment will be referred to herein as the “Above Ground Equipment,” and it is only the Above Ground Equipment sold to governmental entities for which the refund is being requested.

5. This Above Ground Equipment may be located inside buildings or pump houses or it may be outside. Although bolted to the floor and bolted to the pipeline, or bolted to other items of Above Ground Equipment, the Above Ground Equipment at issue in this appeal can be removed for repairs or replacement, or for use at a different location. These items can be removed without damage to the item, the other above ground equipment, or to any other real or personal property.⁴

6. Some of the Above Ground Equipment is actually below ground, but it is not buried. These items are housed inside a vault structure and easily accessible to the Taxpayer’s customers for their purposes as well as for repairs or removal.⁵

² Exhibit 1.

³ Exhibit 1.

⁴ Testimony of REPRESENTATIVE FOR TAXPAYER-3, Vice President TAXPAYER.

⁵ *Id.*

7. Some of the contracts at issue did not involve construction of a building or pipeline system. These were contracts to upgrade and replace equipment inside an existing building and connected to an existing water system. REPRESENTATIVE FOR TAXPAYER-3, Vice President of TAXPAYER, testified regarding some of the transactions involving Above Ground Equipment. For instance, the Taxpayer had upgraded the pumps at the BUSINESS-1. The Taxpayer provided upgrades to the pumps and appurtenances, which allowed a reservoir to be removed from service. In this transaction, the Taxpayer removed and replaced pumps, piping, valves, fittings and gauges that were located inside an existing well house and attached to an existing water system. All of the equipment the Taxpayer provided in this transaction was above ground.⁶

8. The Taxpayer testified that the Above Ground Equipment was constructed in such a manner that it could be unbolted and removed for repairs or replacement. He testified that for a flow control project in which the Taxpayer had installed large valves inside a structure, the purchaser on that contract had already taken the valves out of the building through a hatch in the roof to have them retrofitted. He testified that it was common for the pump houses, well houses or other buildings in which this equipment is installed to have hatches in the roof so that equipment can be removed and replaced with a crane. He also stated that it was common for the pieces of equipment to be constructed with hooks at the top so it could be craned out.⁷

9. REPRESENTATIVE FOR PETITIONER-3 testified that the Above Ground Equipment often cost substantially more than the cost to install the equipment. He pointed to lines on an invoice for Job 1201, which showed \$\$\$\$ for materials and \$\$\$\$ for the installation of the materials.⁸

10. The Taxpayer submitted at the hearing photographs and a description of the projects that involved the Above Ground Equipment at issue.⁹ REPRESENTATIVE FOR PETITIONER-3 testified that the Taxpayer had added a booster station to the ENTITY-1 water system. ENTITY-1 had contracted for this because it had insufficient water pressure in a zone east of LOCATION. For this job, the Taxpayer installed pumps, piping, valves, fittings, gauges, and meters to construct a functioning booster pump system to pump water from a low-pressure line and discharge it into another higher-pressure line. This required the installation of Above Ground Equipment, which is located inside a pump or well house.¹⁰ In some of the other projects involving Above Ground Equipment, the Taxpayer built well houses for CITY-1, CITY-2 and CITY-3. Each of these cities had developed a new well and contracted with the Taxpayer to install deep well pumps that would discharge water from the new well into the city's existing

6 Testimony of REPRESENTATIVE FOR TAXPAYER-3 and Exhibit 11.

7 Testimony of REPRESENTATIVE FOR TAXPAYER-3 and Exhibit 30.

8 Exhibit 114.

9 Exhibits 9-39.

10 Testimony of REPRESENTATIVE FOR TAXPAYER-3 and Exhibit 12.

water distribution systems.¹¹ There was the BUSINESS-2 Upgrade, which provided updated equipment and piping at an existing facility for better water flow monitoring and more reliable water.¹² There was the construction of new sewer lift station for the town of CITY-4. This was needed due to growth of the town, which is low in elevation and has to pump all sewage uphill to a treatment plant.¹³ There was the BUSINESS-3 project where the current system was insufficient to meet demands for the water supply. The Taxpayer added an additional pump to an existing pump station.¹⁴ There was the BUSINESS-4 for the City of CITY-5. CITY-5 built a new concrete reservoir and selected the Taxpayer to build a pump station to pump water out of the reservoir and push it uphill for purposes of pressurized irrigation.¹⁵ In one project the Taxpayer had constructed an irrigation/recreational pond for the city of CITY-6. The Taxpayer constructed this pond with a DESCRIPTIONS REMOVED, but it also was a functioning irrigation water system. The items of Above Ground Equipment used in this project were flow meters to measure water entering the pond and Waterman Gates used to back up the water in the pond and to allow diversion from the pond to ditches and pipelines as needed.¹⁶ For CITY-7, the Taxpayer had constructed a booster pump station to take water from the existing transmission line and boost the pressure up over a hill to get the water into a water distribution line.¹⁷ The Taxpayer had also constructed an ##### linear foot water pipeline for CITY-7 from a pump station to tie into an existing water system in CITY-7.¹⁸ The Taxpayer replaced an aging sewer lift for CITY-8, which required pumps to move sewage into a forced main pipeline.¹⁹ For CITY-9 the Taxpayer built a pump station to pump water out of a canal and push it into a pressurized irrigation system.²⁰ The Taxpayer had constructed a pipeline system with ##### feet of #####” pipe, which conveyed water from the ENTITY-2 to the ENTITY-3 and ENTITY-4. In addition to the pipeline, the Taxpayer constructed a fluoride building, mainline valve vaults and other drain facilities.²¹

11.REPRESENTATIVE FOR PETITIONER-3 testified regarding his frustration as a business owner on how difficult it was to know and understand how to apply the tax laws to his business. He stated that he wanted to be on the same “playing field” as the competitors he is bidding against. He testified that his competitors might have been underbidding him because they were purchasing the pumps, gauges and valves used in their projects tax free and so were able to charge less on the project. He

11 Exhibits 13, 20 & 29.

12 Exhibit 14.

13 Exhibit 15.

14 Exhibit 17.

15 Exhibit 18.

16 Exhibit 23.

17 Exhibit 26.

18 Exhibit 27.

19 Exhibit 33.

20 Exhibit 36.

21 Exhibit 38.

testified that as a business owner, whether an item was buried or above ground would be an easy way to keep track of what property was real property as opposed to what was personal property for sales tax purposes.

12. REPRESENTATIVE FOR PETITIONER-3 testified that the Taxpayer did fabricate some of its own parts and sold some of the parts it fabricated as “outside” sales, or sales where the Taxpayer did not install the part. In 2016 the Taxpayer had \$\$\$\$ in these outside sales. However, the testimony was that in 2012 there had been only \$\$\$\$ in outside sales, out of \$\$\$\$ in total sales.

13. When the Taxpayer purchased materials used in the performance of its contracts, whether they were for Above Ground Equipment or the buried pipelines, the Taxpayer paid sales tax at the time it purchased the materials. This is consistent with how a real property contractor would pay tax on construction materials and other items of tangible personal property used in the construction of a real property improvement under Rule R865-19S-58. If the Taxpayer was reselling these items as tangible personal property, as the Taxpayer now claims, the Taxpayer could have provided exemption certificates to the sellers, rather than pay sales tax at the time it purchased the items used in the Above Ground Equipment. The Taxpayer did not do this, as the Taxpayer treated the transactions at issue as if they were real property contracts. It is the sales tax that the Taxpayer paid at the time it purchased these items that the Taxpayer is requesting be refunded.

14. The Taxpayer generally only contracted with governmental entities for the installations of buried pipelines, pump stations and lift systems. All of the items of Above Ground Equipment that are at issue in the refund request were sold to a governmental entity. For tax purpose, the Taxpayer treated the transactions between itself and the governmental entity as a real property contract at the time of the transaction. However, after filing the refund request the Taxpayer went back to the governmental entities and asked them for exemption certificates. The governmental entities have now provided exemption certificates indicating they received items of personal property from the Taxpayer.²² These certificates do not list specifically which items the governmental entities considered to be personal property.

15. NAME-1, Tax Consultant, hired by Taxpayer, testified that the intent test argued by the Division in this matter is too hard or too subjective for businesses to follow and the test should be the item itself, and the manner in which it is attached. He also testified that the Division had issued refunds for the same audit period to three other taxpayers for the same type of equipment as the Above Ground Equipment at issue in this appeal.

²² Exhibit 5.

APPLICABLE LAW

Utah Code Sec. 59-12-103(1) (2012)²³ imposes tax on a purchaser as follows:

A tax is imposed on the purchaser as provided in this part for amounts paid or charged for the following transactions:

- (a) retail sales of tangible personal property made with the state;

In 2012 “tangible personal property” was defined at Utah Code Sec. 59-12-102(118) as follows:

- (a) Except as provided in Subsection (118)(d) or (e), “tangible personal property” means personal property that:
 - (i) may be: (A) seen; (B) weighed; (C) measured; (D) felt; or (E) touched; or
 - (ii) is in any manner perceptible to the senses.
- (b) “Tangible personal property” includes the following regardless of whether the item is attached to real property:
 - (i) electricity;
 - (ii) water;
 - (iii) gas;
 - (iv) steam; or
 - (v) prewritten computer software, regardless of the manner in which the prewritten computer software is transferred.
- (c) “Tangible personal property” includes the following regardless of whether the item is attached to real property:
 - (i) a dishwasher;
 - (ii) a dryer;
 - (iii) a freezer;
 - (iv) a microwave;
 - (v) a refrigerator;
 - (vi) a stove
 - (vii) a washer; or
 - (viii) an item similar to Subsections (118)(c)(i) through (vii) as determined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act.
- (d) “Tangible personal property” does not include a product that is transferred electronically.
- (e) “Tangible personal property” does not include the following if attached to real property, regardless of whether the attachment to real property is only through a line that supplies water, electricity, gas, telephone, cable or supplies a similar item as determined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act:
 - (i) a hot water heater;
 - (ii) a water filtration system; or
 - (iii) a water softener system.

²³ For the substantive provisions of law this decision will refer to the 2012 Utah Code for ease of reference. Some code provisions were renumbered over the tax period at issue in this appeal, however, there were no material differences.

Exemptions to the imposition of sales tax are set out at Utah Code Sec. 59-12-104 (2012). The exemptions at Utah Code Sec. 59-12-104 applicable to the parties' arguments in this appeal are as follows:

The following sales and uses are exempt from the taxes imposed by this chapter:

...

(2) subject to Section 59-12-104.6, sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of:

(a) construction materials except:

...

(ii) construction materials purchased by the state, its institutions, or its political subdivisions which are installed or converted to real property by employees of the state, its institutions, or its political subdivisions;

...

(25) a product purchased for resale in this state, in the regular course of business, either in its original form or as an ingredient or component part of a manufactured or compounded product;

For the purposes of the exemption at Utah Code Sec. 59-12-104(2) "construction materials" is defined at Utah Code Sec. 59-12-102(30) (2012) to be:

"Construction materials" means any tangible personal property that will be converted into real property.

Utah Code Sec. 59-1-1410(7) provides for refunds as follows:

If a person erroneously pays a liability, overpays a liability, pays a liability more than once, or the commission erroneously receives, collects, or computes a liability, the commission shall:

(a) credit the liability against any amount of liability the person owes; and

(b) refund any balance . . .

Utah Code Sec. 59-1-1417 codifies which party has the burden of proof in proceedings before the Tax Commission and provides for statutory construction as follows:

(1) In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following in which the burden of proof is on the commission:

...

(2) Regardless of whether a taxpayer has paid or remitted a tax, fee, or charge, the commission or a court considering a case involving the tax, fee, or charge shall:

(a) construe a statute imposing the tax, fee, or charge strictly in favor of the taxpayer; and

(b) construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer.

Utah Admin. Rule R865-19S-23 provides the following guidance regarding sales and use tax exemptions:

A. Taxpayers selling tangible personal property or services to customers exempt from sales tax are required to keep records verifying the nontaxable status of those sales.

. . .

C. A seller may retain a copy of a purchase order, check, or voucher in place of the exemption certificate as evidence of exemption for a federal, state, or local government entity, including public schools.

D. If a purchaser is unable to segregate tangible personal property or services purchased for resale from tangible personal property or services purchased for the purchaser's own consumption, everything should be purchased tax-free. The purchaser must then report and pay the tax on the cost of goods or services purchased tax free for resale that the purchaser uses or consumes.

. . .

Utah Admin. Rule R865-19S-58 provides sales tax guidance regarding purchases by real property contractors or repairmen as follows:

(1) Sales of construction materials and other items of tangible personal property to real property contractors and repairmen of real property are generally subject to tax if the contractor or repairman converts the materials or items to real property.

(a) "Construction materials" include items of tangible personal property such as lumber, bricks, nails and cement that are used to construct buildings, structures or improvements on the land and typically lose their separate identity as personal property once incorporated into the real property.

(b) Fixtures or other items of tangible personal property such as furnaces, built-in air condition systems, or other items that are appurtenant to or incorporated into real property and that become an integral part of a real property improvement are treated as construction materials for purposes of this rule.

(2) The sale of real property is not subject to sales tax, nor is the labor performed on real property. For example, the sale of a completed home or building is not subject to the tax, but sales of materials and supplies to contractors for use in building the home or building are taxable transactions as sales to final consumers.

(a) The contractor or repairman who converts the personal property to real property is the consumer of tangible personal property regardless of the type of contract entered into whether it is a lump sum, time and material, or a cost-plus contract.

(b) Except as otherwise provided in Subsection (2)(d), the contractor or repairman who converts the construction materials, fixtures or other items to real property is the consumer of the personal property whether the contract is performed for an individual, a religious or charitable institution, or a government entity.

. . .

(4) This rule does not apply to contracts where the retailer sells and installs personal property that does not become part of the real property. Examples of items that remain tangible personal property even when attached to real property are:

(a) moveable items that are attached to real property merely for stability or for an obvious temporary purpose;

(b) manufacturing equipment and machinery and essential accessories appurtenant to the manufacturing equipment and machinery;

(c) items installed for the benefit of the trade or business conducted on the property that are affixed in a manner that facilitates removal without substantial damage to the real property or to the item itself . . .

Utah Admin. Rule R865-19S-2 provides that sales tax is imposed on the transaction and not the item of property as follows:

- A. The sales and use taxes are transaction taxes imposed upon certain retail sales and leases of tangible personal property, as well as upon certain services.
- B. The tax is not upon the articles sold or furnished, but upon the transaction, and the purchaser is the actual taxpayer. The vendor is charged with the duty of collecting the tax from the purchaser and of paying the tax to the state.

DISCUSSION

The Taxpayer's position is that this appeal is resolved based on the single issue of whether the Above Ground Equipment is real property or personal property. The Division argues a number of additional points, but primarily as noted by the Taxpayer, the resolution of this appeal depends on whether the Above Ground Equipment is sold by the Taxpayer to the governmental entity purchaser as tangible personal property, as that term is used in Utah Code Sec. 59-12-103(1)(a) (2012). If the Above Ground Equipment is sold as tangible personal property, the Taxpayer could have purchased the pumps, valves, gauges and materials used for the Above Ground Equipment as a purchase for resale exempt under Utah Code Sec. 59-12-104(25) (2012). As a purchase for resale, the Taxpayer would have had to charge sales tax on its contract with the purchaser, unless an exemption applied to that second transaction. In this appeal, because the purchasers were governmental entities, if the Above Ground Equipment was personal property at the time of the sale to the governmental entities, and not construction materials as defined in the statute, the sale to the governmental entities would also be exempt from tax under Utah Code Sec. 59-12-104(2)(2012).

The parties significantly differ on what factors should be considered in determining what is tangible personal property and what is real property. The Taxpayer's representative argues that the primary test should be the physical characteristics of the items themselves and how they are attached to the real property, while the Respondent argues the test involves scrutiny of the essence of the transaction. The Taxpayer argues that its test would make it easier for contractors to understand how to comply with sales tax law. For example, if the test was limited to the physical characteristics of property and how it is attached, a water pump, which is one of the items at issue, would appear to be personal property. Unrefuted testimony indicated the water pumps, which the Taxpayer purchased and installed as part of its contracts, is a piece of equipment that can be removed without damage to the real property or the pump itself. The pumps are bolted in place and the bolts can be removed as needed. The buildings in which

they are located are built with doors or hatches through which this equipment can be removed. The Taxpayer testified that these pumps are often removed for repairs, refurbishment or replacement. The pumps can be moved and reused at other locations. The Taxpayer points out that the Utah Supreme Court in *Nickerson Pump & Machinery Co. v. State Tax Commission*, 12 Utah 2d 30 (1961), 361 P.2d 520, held that the pumps, which were furnished and installed by Nickerson remained personal property after installation. Some of the pumps at issue in this appeal were Nickerson Pumps or were similar in physical characteristics to the Nickerson pumps.

The Taxpayer's representative argues that the Division's position, that it is the essence of the transaction or contract and not the individual piece of equipment that needs to be considered, is an unworkable test for business owners. The Taxpayer had testified that he suspected his competitors were able to underbid him because they were not paying sales tax at the time they purchased items similar to the Above Ground Equipment when they constructed projects for government agencies. The Taxpayer's tax consultant testified that the Division had issued refunds for three other taxpayers for the same type of equipment and same audit period, although he did not provide details regarding the type of transactions or contracts those sales involved. The Taxpayer also points to information published by the Commission during the audit years, which did not directly discuss the type of transactions at issue in this appeal and left it unclear how Taxpayers were to treat these type of transactions. The Taxpayer provided a copy of Publication 42, Sales Tax Guidelines (Revised 6/99) that provided the following at pages 4-6:

Items Not Converted to Real Property

The rules stated above do not apply to sales of items that remain tangible personal property even when attached. The sale of an item which remains personal property, even when affixed to real property, is taxable to the last purchaser.²⁴

If an item is attached merely for stability, convenience or any other temporary purpose, it is not converted to real property and the final purchaser is liable for the sales tax. For instance, a t.v. antenna or satellite dish does not become an integral part of the real property, even if attached to the purchaser's home and even if its wiring is dropped inside the house.

...

Here are some other examples of items that remain tangible personal property even when attached:

...

❑ Public utility lines or pipelines are generally considered real property if installed underground. Taxability of purchases or other public or private utility line or pipeline materials should be determined on the basis of applicable tests in Administrative Rule R865-19S-58 indicating whether such materials constitute real property upon installation to the realty or remain tangible personal property.

24 Publication 42 was revised June 2014. This version indicated at page 3, "Tangible personal property that is considered permanently attached to real property includes: . . . –Property attached to oil, gas or water pipelines." Then in the Examples on page 6, it provides, "Above ground pipes that are permanently attached . . . Treat as personal property and taxable to the final buyer." On page 9 of the Examples, "Water filtration system (includes well pumps) . . . Treat as real property taxable to the seller, if sold under furnish-and-install contract or by someone working for the seller. If sold to the buyer for installation by someone other than the seller, treat as personal property taxable to the final buyer."

The Taxpayer also argues that in *Morton International, Inc. v. Tax Comm'n*, 814 P.2d 581 (Utah 1991), the more recent *Crossroads Plaza Assoc. v. Pratt*, 912 P.2d 961 (Utah 1996) and two Tax Commission decisions, intent was minimized as a factor and the decisions were based more on the physical characteristics of the property and how it was attached. The Tax Commission decisions cited by the Taxpayer were *Utah State Tax Commission Findings of Fact, Conclusions of Law, and Final Decision*, Appeal No. 05-1035 (2007) and *Order Denying Respondent's Motion to Dismiss*, Appeal No. 15-761. However, the Taxpayer did acknowledge in other prior Tax Commission decisions intent factors were given significant consideration.

The Division argues that it is insufficient to look at only the actual physical attributes of each specific item of equipment and how it is attached to real property, but instead the test was the intent of the contract and essence of the transaction. The Division notes that sales tax in general is a tax on the transaction and not on the specific item, citing Utah Admin. Rule R865-19S-2. The Division argues the test should be based on the transaction.²⁵ The Division also cites decisions issued by the courts, which have considered the intent of the contract and essence of the transaction as significant factors.²⁶ Under the Division's position, it is possible that a pump would be real property as part of a real property contract, or could be personal property if sold individually. The Division argues that in the transactions at issue with the Above Ground Equipment, the governmental entities are not purchasing individual pieces of equipment, but instead a functioning water system, most of which is buried underground and real property. The pumps, valves, gauges and other items of Above Ground Equipment are a necessary part of the entire water pipeline system. Although an individual pump, valve or gauge might be removable or replaceable with little damage to the surrounding pipe sections, the Division points out the entire pipeline system is not removable without significant damage to the ground as well as the pipeline. It was the Division's position that the essence of the transactions between the Taxpayer and the governmental entities was for a complete and functioning water pipeline system. The Division rejected the Taxpayer's interpretation that *Morton International* and *Crossroads Plaza* stand for the position that the intent of the transaction is no longer the proper test. The Division also argued that if a refund were to be issued, it should be issued to the governmental entities, not to Petitioner.

25 The Division also argued that there had been "no error committed by the Tax Commission in accepting the tax as remitted" arguing that based on the decision in *Ivory Homes v. Utah State Tax Comm'n*, 2011 Utah 54 the Taxpayer was not entitled to a refund. See Auditing Division's Pre-Hearing Brief, pg. 5. As noted by the Taxpayer, the statute was revised by the Utah Legislature in response to the decision in *Ivory Homes* to remove this as a requirement for issuing a refund.

26 The Division relies on *Concrete Products Corp. v. State Tax Comm'n*, 125 P.2d 408, 411 (Utah 1942); *Niederhauser Ornamental and Metal Works, Inc. v. Utah State Tax Comm'n*, 858 P.2d 1034 (Utah 1993); *Valgardson Housing Systems, Inc. v. State Tax Comm'n*, 849 P.2d 618 (1993); and *Superior Soft Water v. State Tax Comm'n*, 843 P.2d 525 (Utah App. 1992).

In reviewing the applicable law, arguments of the parties, and prior case law and decisions, the statute provides a framework that taxes differently items sold as real property versus items sold as personal property, leaving it up to the Tax Commission and the courts to provide guidance and clarification on how this is applied in the facts and circumstances of the numerous transactions that occur. Utah Code Sec. 59-12-103(1)(a) imposes sales tax on “retail sales of tangible personal property made within the state” unless an exemption applies. Utah Code Sec. 59-12-103 does not impose sales tax in general on the sale of real property. Guidance is given in Utah Admin. Rule R865-19S-58 regarding items of tangible personal property acquired by real property contractors. Subsection R865-19S-58(1) provides, “Sales of construction materials and other items of tangible personal property to real property contractors and repairmen of real property are generally subject to tax if the contractor or repairman converts the materials or items to real property.”

There is no guidance in this rule discussing directly items used in pipeline systems or attached to pipeline systems. Subsection R865-19S-58(1)(b) provides an example of items that have some functional similarities as the gauges, pumps and valves would have to a pipeline system. It provides that items such as furnaces, air-conditioning systems, “or other items that are appurtenant to or incorporated into real property and that become an integral part of a real property improvement are treated as construction materials for purposes of this rule.” The rule also provides some examples of items that do not become part of the real property and remain tangible personal property at Subsection R865-19S-58(4). This subsection provides that “moveable items that are attached to real property merely for stability” remain personal property. Although the Above Ground Equipment may be attached for stability, it is not attached “merely” for stability. The primary purpose of the attachment to the pipeline, valves and gauges is for the equipment to function as part of the water system.

The task then is to apply this statutory framework and guidance provided in the administrative rule to municipal water pipeline or sewer systems. The Tax Commission has previously concluded that underground pipeline systems were real property in *Utah State Tax Commission Findings of Fact, Conclusions of Law and Final Decision*, Appeal No. 11-1774 (2014).²⁷ Because the parties stipulated in that appeal regarding the types of items that comprise the Above Ground Equipment, the issue of Above Ground Equipment was not addressed in that decision. In the subject appeal, the parties offer divergent tests for determining which items become real property and which remain personal under the statutory framework, with the Taxpayer arguing for a test that focuses on each individual item and how it is attached and the Division arguing for a test that considers the transaction. Under the Taxpayer’s test all water pumps attached in a similar manner to the ones at issue in this hearing would be personal property.

²⁷ The Tax Commission’s decision in Appeal No. 11-1774 was appealed for judicial review and that appeal is still pending.

Under the Division's test, whether a water pump was real or personal would depend on the contract between the parties.

The parties point to *Nickerson Pump & Machinery Co. v. State Tax Commission*, 12 Utah 2d 30 (1961), 361 P.2d 520, with the Taxpayer noting that some of the water pumps that are at issue in this appeal had been acquired by the Taxpayer from Nickerson Pump. Nickerson Pump was a dealer that specialized in water pumps and had a retail sales license. The issue in *Nickerson* involved lump sum contracts where Nickerson assembled water pumps from parts to the specification of the governmental agencies and "emplaced" the water pumps at the needed location. There was no indication that Nickerson provided or installed pipelines, or any other equipment. From the facts described in that case, the entire transaction between Nickerson and the governmental entity was the provision and emplacement of the pumps. The Court describes the arrangement as follows:

The deficiency assessment was based on water pumps assembled from parts to the specifications of the governmental agencies and emplaced by plaintiff under lump sum contracts. In lump sum contracts the cost of labor for emplacement of the pumps is included in the price charged for the pumps and is not charged separately. However, the actual cost is considered as a separate item and included by the plaintiff in its computation in arriving at the amount it will bid to obtain the business.

...
Pumps are emplaced without permanent attachment to realty so that they may be readily removed for use in other places or for repairs which are frequently necessary.

Id. at 520. In *Nickerson* the court noted that the issue was whether "the facts sustain a conclusion that the emplacement by Plaintiff of the assembled pumps change their nature from personalty to realty, thereby making it the ultimate consumer of the personal property used in the assemblage of the water pumps." *Id.* at 522. The Court concluded the pumps remained personal property. The Court provided the following explanation:

When assembled, delivered and installed the water pumps were entities which were readily removable without harm to the structures in which they were placed. Other pumps could easily be placed in these structures. The pumps themselves were so manufactured, even though to specification, that they could be used on different locations when it was convenient for the buyers to transfer them to such locations. It was contemplated that the pumps would not remain where placed but would be removed either for repairs or for changes in location. **The Primary purpose of the agreements were for the sale and purchase of water pumps assembled to particular specifications. The emplacement was incidental to such purpose and was a mere convenience for the purchaser because of the great weight of the pumps which required special equipment to move them.** (Emphasis added.) *Id.* at 522.

The physical characteristics of the pumps and how they are attached as described in *Nickerson* are the same as for the water pumps in the subject appeal. However, *Nickerson* does not support the Taxpayer's argument that the test be based primarily on these physical characteristics, because the Court

in *Nickerson* had also considered intent or essence of the transaction factors in its conclusions and these factors in *Nickerson* weighed in favor of the pumps being taxed as personal property. Nickerson was not a real property contractor. The Court described Nickerson as dealer with a retail sales tax license specializing in water pumps. Whereas the entirety of the transaction between Nickerson and the government entity was the sale and installation of a water pump, in the subject appeal the transaction is much broader. The government entity in the subject appeal is contracting not just for a single water pump, but instead for construction of functioning well houses, pump stations, booster stations and sewer lifts, which are part of a much larger municipal water system or sewer system. The installation of the pumps, valves, gauges and other items of Above Ground Equipment are only a part of the transaction.

In Appeal No. 11-1774, and in another decision issued by the Tax Commission shortly thereafter, *Initial Hearing Order* Appeal No. 13-488 (2014), the Tax Commission applied the nine factor test set out in *Nickerson*, *Chicago Bridge & Iron Co. v. State Tax Comm'n*, 839 P.2d 303 (Utah 1992), and *B-J Titan Services v. State Tax Comm'n*, 842 P.2d 822 (Utah 1992). The nine factors as articulated by the Tax Commission in Appeal Nos. 11-1774 and 13-488 are: (1) whether the property is removable without harm to the structure on which it is placed; (2) whether the property is manufactured with the idea that it could be used elsewhere; (3) whether the parties to the transaction contemplated that the property would be removed for repairs or replacement; (4) whether the primary purpose of the transaction was for the property or the installation of the property; (5) whether the installation was for convenience; (6) whether the transaction indicated that the property was to be treated as real property after installation; (7) whether the purchaser intended to purchase real property; (8) whether the property becomes inseparably meshed into a greater facility which is the object of the transaction; and (9) whether the property becomes attached to real property.”

Considering the Taxpayer’s position that the Utah Supreme Court decisions in *Morton International* and *Crossroads Plaza* indicate intent of the contract or essence of the transaction factors are no longer relevant,²⁸ after a careful reading of these cases they do not support the Taxpayer’s conclusion. The Utah Supreme Court issued its decision in *Morton International* in 1991, prior to the decisions *Niederhauser Ornamental and Metal Works, Inc. v. Utah State Tax Comm’n*, 858 P.2d 1034 (Utah 1993);

28 The Taxpayer had also cited Tax Commission Findings of Fact, Conclusions of Law and Final Decision in Appeal No. 05-1035 (2007) as support that the Tax Commission has previously placed more weight on the physical characteristics instead of the intent of the parties. That decision is distinguishable factually from the subject appeal, as that taxpayer was providing only one type of item under a subcontract agreement with a general contractor. Appeal No. 05-1035 was similar factually to *Nickerson Pump*. In Appeal No. 05-1035 the subcontract required the taxpayer to provide and emplace along a roadway cement constant slope barriers, which were not attached in any manner to the ground, except by their weight and were designed to be repositionable. In Appeal No. 05-1035 there was in the Findings of Fact testimony regarding intent of the parties that was apparently not in dispute. The Taxpayer had also cited the Utah State Tax Commission’s Order Denying Respondent’s Motion to Dismiss in Appeal No. 15-761 (2016). This is not the final decision in Appeal No. 15-761 as that appeal is scheduled for a Formal Hearing at a future date.

Chicago Bridge & Iron Co. v. State Tax Comm'n, 839 P.2d 303 (Utah 1992); and *B-J Titan Services v. State Tax Comm'n*, 842 P.2d 822 (Utah 1992). In the latter decisions, the Court had applied intent based tests. In *Morton International*, Morton had proposed a test that “focused on the function that the particular structure performs in determining if the structure should be considered equipment.” *Morton International* at 593. The Court in *Morton International* rejected Morton’s argument, finding as follows, “Therefore, even if we held that section 59-12-104(16) contemplates a functional approach in determining whether a structure was equipment or real property, it would not necessarily follow that Morton’s facilities would constitute equipment.” *Id.* at 594. In the subsequent court decisions, however, intent factors were considered and the nine factor test articulated.

The Taxpayer also relies heavily on the Utah Supreme Court’s decision in *Crossroads Plaza*, which the court issued in 1996. As noted by the Division, *Crossroads Plaza* involved property tax and the interpretation of statutes in the Property Tax Act. The issue in that case was whether the owner of the shopping mall was ultimately responsible for property tax on leasehold improvements under the control of the lessee who had not paid the tax. In that case the conclusion reached by the Utah Supreme Court was that, “While taxes on leasehold improvements may be assessed and collected from the lessee in control of such improvements, owners of the underlying real property are ultimately responsible for taxes due on such improvements under section 59-2-1325 of the Utah Code.” *Crossroads Plaza* at 968-969. In reaching this conclusion, the Court interpreted the definition of “improvement” set out in the Property Tax Act at 59-2-102²⁹ finding that leasehold improvements were “improvements” and “improvements” were “real property.” *Id.* at 966.

Crossroads Plaza involved property tax and the interpretation of statutes in the Property Tax Act. In the subject appeal the issue is whether the property is “tangible personal property” or “real property” for purposes of the Sales and Use Tax Act. However, as the Taxpayer noted, the Court in *Crossroads Plaza* did cite for guidance prior decisions regarding the distinction between real and personal property for sales tax purposes including *Nickerson Pump*, *Chicago Bridge & Iron* and *Valgardson Hous. Sys. v. State Tax Comm'n*, 849 P.2d 618 (Utah Ct. App.), cert. denied, 859 P.2d 585 (Utah 1993).³⁰ The Court in

29 In *Crossroads* the Court quotes the definition for “improvement” to be the 1992 law found at Utah Code Ann. Sec. 59-2-102(11), which is in the Property Tax Act. The Court states the law provided that, “‘Improvements’ include ‘all buildings, structures, fixtures, fences and improvements erected upon or affixed to the land, whether the title has been acquired to the land or not.’” *Crossroads Plaza* at 967. “Improvement” is not a defined term in the Sales and Use Tax Act during the years at issue in the subject appeal and is not a term used in the tax imposition statute at issue or exemptions statutes at issue in the subject appeal.

30 A discussion by the Court in *Crossroads Plaza*, which further confuses whether the Court’s interpretation was to apply to sales tax cases, was the statement and reference in *Crossroads Plaza* at page 968 made in regards to *Great Salt Lake Minerals & Chems. Corp.* 573 P.2d at 337(1977). In *Crossroads* the Court stated, “Similarly, in another tax case, we reiterated that a Utah sales tax statute identical to the property tax statute at issue in this case defines “improvements” as “all buildings, structures, fixtures, fences and improvements erected upon or affixed to land . . .”

Crossroads Plaza holds, “Whether property constitutes “improvements” to real property for tax purposes depends on whether such property is “erected upon or affixed to the” the underlying property.”³¹ It is unclear if, or how, the Court would intend this property tax definition and test for “improvement” to be applied in a sales tax context. The cases that specifically dealt with whether items were tangible personal property or real property under sales tax law clearly support the nine factor test that considers both intent factors and the physical characteristics of the item and how it is attached. Without clarification from the Court that the *Crossroads Plaza* definition of improvement is to be applied in the sales tax context, the Commission should continue to apply the nine factor test that has been set out in the prior sales tax cases including *Niederhauser Ornamental and Metal Works, Inc. v. Utah State Tax Comm’n*, 858 P.2d 1034 (Utah 1993); *Chicago Bridge & Iron Co. v. State Tax Comm’n*, 839 P.2d 303 (Utah 1992); *B-J Titan Services v. State Tax Comm’n*, 842 P.2d 822 (Utah 1992) and *Nickerson Pump & Machinery Co. v. State Tax Commission*, 12 Utah 2d 30 (1961), 361 P.2d 520, and applied by the Tax Commission in *Utah State Tax Commission Findings of Fact, Conclusions of Law and Final Decision*, Appeal No. 11-1774 (2014) and Initial Hearing Order Appeal No 13-488 (2014).

This nine factor test considers both intent factors and physical characteristics of the property and how it is attached. Applying these nine factors to the Above Ground Equipment, on balance they support that the Above Ground Equipment is converted to real property rather than remaining personal property. The first criterion is whether the equipment was removable without harm to the structure in which it is placed. In this case if Above Ground Equipment items are removed from the water system, the water system would not function. The second factor is whether the property is manufactured with the idea that it could be used elsewhere. Many of the individual pieces of Above Ground Equipment could be used elsewhere, but the completed system would be specifically designed for the needs of that location. The third requirement was whether the parties to the transaction contemplated that the property would be removed for repairs or replacement. Individual pieces may be removed for repairs or replacement, but not necessarily the system. The fourth consideration is whether the primary purpose of the transaction was for the item of property or for the installation of the property. In general, the primary purpose of the transaction was for a functioning well house, booster station, sewer lift or pump station, not any individual item of Above Ground Equipment. This is similar to the fifth consideration, which was whether the installation was for convenience. The governmental entity was contracting for a complete functioning component of a water system, installation of individual pieces of equipment were more than just convenience.

Citing *Great Salt Lake Minerals* at 339. The reference to a “sales tax statute” defining improvements is a misstatement by the Court in *Crossroads*, because the statutory definition the Court cited in *Great Salt Lake Minerals* was not a sales tax statute, but a statute in the Tax Equivalent Property Act.

³¹ *Crossroads Plaza* at 968.

The sixth consideration is whether the transaction indicated that the property was to be treated as real property after installation and the seventh whether the purchaser intended to purchase personal or real property. At the time the Taxpayer and governmental entity entered into the contracts it appears their intent was for a real property contract, because that is how they treated the transactions. The Taxpayer paid sales tax on its purchases of the items that comprise the Above Ground Equipment, and did not ask for exemption certificates from the governmental entity. This is consistent with a real property contract. Only after filing this refund request, did the Taxpayer's representative go back to the governmental entities and request exemption certificates for items of personal property.

The eighth consideration is whether the property becomes inseparably meshed into a greater facility, which is the object of the transaction. The individual items of Above Ground Equipment are inseparably meshed in the way that they are necessary for the well house or booster station to function. They are not meshed in a way similar to how bricks and mortar would become inseparable from a building. However, Utah Admin. Rule R865-19S-58 has clarified that fixtures or other items of tangible personal property such as furnaces and built-in air conditioning systems become an integral part of a real property improvement. This is functionally similar to how the pumps, valves and gauges become meshed into the water system. The final consideration is whether the property becomes attached to real property. The Above Ground Equipment is attached to a real property water pipeline or sewer system and needs to be attached to function. Based on a weighing of these nine factors the Above Ground Equipment is real property.

The Taxpayer had argued how difficult it is to know the tax law and expressed the concern that if their competitors were doing something different it would give them an unfair advantage. However, it does appear that the Taxpayer was correctly paying the sales tax and accounting for their transactions during the refund period at issue and only questioned this tax treatment after the fact. Applying a nine factor test does make it more complex and fact intensive to determine what is real and what is personal property than the test offered by the Taxpayer that looks at the individual item and how it is physically attached. However, this is the test set out by the courts and it would be up to the courts or the Utah Legislature to simplify the test.

CONCLUSIONS OF LAW

1. Utah Code Sec. 59-12-103(1) imposes sales tax on the purchaser “for amounts paid or charged for the following transactions” and one of the transactions listed is “retail sales of tangible personal property.” Based on this, the Taxpayer was required to pay sales tax at the time the Taxpayer purchased the items that comprise the Above Ground Equipment, unless an exemption applies. The Taxpayer did pay the sales tax at the time of purchase and is requesting a refund of this sales tax.

2. Exemptions from sales and use tax are found at Utah Code Sec. 59-12-104 and the Taxpayer now argues that its purchases were exempt under 59-12-104(25) (2012) as a product purchased for resale “either in its original form or as an ingredient or component part of a manufactured or compounded product.” Had the Taxpayer been purchasing the pumps, valves, gauges and pipes and reselling them to the governmental entities as items of personal property and not construction materials, this exemption could have applied. However, as discussed above, the Taxpayer was converting these items to real property and selling them as real property to the governmental entities, not personal property. Because the Taxpayer was converting the items to real property, the Taxpayer was consuming the items and not reselling the items. Under the Contractor Rule, which is set out at Utah Admin. Rule R865-19S-58, the Taxpayer correctly paid sales tax at the time it purchased the items of Above Ground Equipment and these items would have been considered “construction materials” within the meaning of that rule.

3. The test to determine if the items of Above Ground Equipment were sold to the governmental entities as personal property or real property is the nine factor test that considers both the intent of the parties based on the contract or the essence of the transaction and the physical characteristics of the items and how they are attached. Based on the nine factor test set out in *Niederhauser Ornamental and Metal Works, Inc. v. Utah State Tax Comm’n*, 858 P.2d 1034 (Utah 1993); *Chicago Bridge & Iron Co. v. State Tax Comm’n*, 839 P.2d 303 (Utah 1992); *B-J Titan Services v. State Tax Comm’n*, 842 P.2d 822 (Utah 1992); *Nickerson Pump & Machinery Co. v. State Tax Commission*, 12 Utah 2d 30 (1961), 361 P.2d 520, and applied by the Tax Commission in *Utah State Tax Commission Findings of Fact, Conclusions of Law and Final Decision*, Appeal No. 11-1774 (2014) and *Initial Hearing Order Appeal No 13-488* (2014), the Above Ground Equipment was real property.

4. As sales tax is not imposed on the sale of real property, the Taxpayer was not required to collect and charge sales tax on the finished real property contracts, and the Taxpayer did not charge this tax. However, if, as the Taxpayer had argued, the Taxpayer was selling items of tangible personal property it would have had to charge sales tax on the final contracts, unless that transaction was also exempt. The Taxpayer argues that its transactions in selling the Above Ground Equipment to the governmental entities would have been exempt under Utah Code Sec. 59-12-104(2) as a sale to a governmental entity. This exemption specifically does not apply to construction materials, unless the construction materials were installed by employees of the governmental entity. In this matter the property items were not being installed by employees of the governmental entity, they were being installed by the Taxpayer. Therefore,

this exemption would only apply if the Taxpayer was selling items of personal property to the governmental entity that were not “construction materials.” “Construction materials” is defined at Utah Code Sec. 59-12-102(30) (2012) to be “any tangible personal property that will be converted into real property.” Because these items were converted to real property, they would have been “construction materials” and would not have qualified under this exemption.

Although the Taxpayer’s position regarding the difficulty in understanding how to properly apply the sales tax law to his business has merit, especially due to the fact that neither the statute nor rule directly address water and sewer pipeline systems. Based on the guidance from cases and prior decisions the Division’s denial of the refund request was appropriate.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Utah State Tax Commission denies the Taxpayer’s appeal of the refund denial for the period of June 2012 through May 2015. It is so ordered.

DATED this _____ day of _____, 2017.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights and Payment Requirement: Any balance due as a result of this order must be paid within thirty (30) days of the date of this order, or a late payment penalty could be assessed. You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §59-1-601 et seq. and §63G-4-401 et seq.